

## ASSOCIATION OF CORPORATE COUNSEL

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**PRESENTED BY:** ACC's Energy Committee

**SPONSORED BY:** Covington & Burling, LLP

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Robert Fleishman, Of Counsel, Covington & Burling

**MODERATOR:** Nicole Spaur, Senior Counsel, Sprague Energy Corp.

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**Operator:** Just a reminder, today's call is being recorded.

**Female:** Welcome to this ACC Webcast. Nicole, please go ahead.

**Nicole Spaur:** Thank you. Welcome to the Webcast on FERC enforcement. My name is Nicole Spaur, and I am the vice chair of the Energy Committee and am serving today as the moderator.

I want to begin by thanking Covington & Burling for supporting the Energy Committee and sponsoring this Webcast. In particular, I want to thank Bob Fleishman and Bill Massey, who will be today's presenters.

First, let's begin with a few housekeeping items. Please note that this session is being recorded, and if you need any technical support during the Webcast, you can e-mail [ACCwebcast@commpartners.com](mailto:ACCwebcast@commpartners.com). At the end of the presentation, we will have a question-and-answer period. So at any time during the presentation, please feel free to go ahead and type any questions you may have in the box located at the lower-left corner of your screen, and then simply hit "send". The presenters will be able to review your questions and will go ahead and provide you with some feedback at the end of the presentation. Also, if everyone could please submit an evaluation form, that will be really helpful as we prepare for future Webcasts. You can simply find it via the link on your screen.

Now, with that, I'd like to introduce the presenters. William Massey has a broad-based energy regulatory and government affairs practice in the Washington D.C. office. He has extensive experience with regulatory issues before the Federal Energy Regulatory Commission and with energy legislative matters before Congress and state general assemblies. Most recently, he served as commissioner at FERC for more than 10 years. Mr. Massey advises investment firms, utilities, independent power producers, pipelines, project developers, customers, marketers and energy companies on a wide variety of energy matters, including mergers and acquisitions, market structure, competition policy, transmission and infrastructure investment, enforcement and investigations and legislative strategy.

Drawing on over 25 years of the Washington insider and counselor, Mr. Massey understands the intersection of policy, legislation and regulation. He offers a highly effective combination of strategic, legal and policy skills to his clients. He practices successful regulatory and legislative advocacy in Washington and in state capitols.

Joining Mr. Massey today is Robert Fleishman, and he represents and advises investor-owned utilities, financial institutions, private equity firms, natural gas pipelines, local distribution companies, oil and gas producers, customers and energy companies on regulatory enforcement, compliance, commercial, legislative and public policy matters and activities. His proven leadership and accomplishments on significant legislation, transactions, litigation and settlements in the energy industry.

In addition, Mr. Fleishman is a mediator, a member of the American Arbitration Association National Roster of Neutrals and a member of the CPR Institute's Energy Oil and Gas Panel of Distinguished Neutrals.

So with that, I'd like to turn it over to Bob and Bill.

**Bill Massey:** OK, this is Bill Massey speaking. Let me get us started here. We are going to speak about FERC enforcement policy. This is a very important topic for energy companies and energy consumers and all users of natural gas pipelines and the high-voltage transmission system in the United States.

I served at the commission during the California electricity crisis, and during that time, we felt as if we didn't really have all the tools that we needed to police a market manipulation, and so a number of us testified on Capitol Hill that we needed more authority at the agency, and – as did Joe Callahern, the current chairman of FERC, and in the Energy Policy Act of 2005, Congress dramatically increased the commission's enforcement authority.

In a number of ways, the commission now has new powers to facilitate transparency. Given that there is some overlap of jurisdiction between FERC and the CFTC, those agencies were directed to conclude a memorandum of understanding with respect to a number of topics, and the Congress gave FERC very explicit authority to prohibit any manipulative or deceptive device in connection with natural gas or electricity markets.

Let's go to slide five, Bob. Importantly, Congress increased the criminal and civil penalties for violations of FERC rules, and these provisions also extended the commission's penalty authority over Part Two of the Federal Power Act, which is the commission's regulation of utilities in interstate commerce and all of the Natural Gas Act, which involves regulation of natural gas pipelines and certain transactional matters.

On slide six, I want to underscore that FERC now has several penalty authority up to \$1 million per day per violation, which it is now true that no other federal agency has any stiffer penalty authority than FERC does. It may now impose \$1 million in criminal fines per violation and up to five years imprisonment, which increases those authorities, as well. It can prohibit certain activities in the energy business. It can require the disgorgement of unjust profits, and the commission can also revoke certain marketing certificates or authorizations that give market participants added flexibility in the marketplace. The commission can take those away as a penalty.

Well, right after this law passed, FERC promulgated an enforcement policy statement that you see on slide seven. FERC's mantra here is that we will engage in firm but fair enforcement, and I think that the industry in general believes that the commission is taking a fairly aggressive role in policing its rules and regulations, and I think the commission believes that that's what Congress wants it to do. But they're also trying to balance that with fairness and due process and so forth. That policy statement also discussed in some detail the balance that FERC would like to achieve in determining the severity of penalties.

Bob, let's go to the next slide, and – now, this sets out the commission's anti-manipulation rule that was in order number 670. This slide is the rule that applies to natural gas market manipulation, and we will discuss some of these elements. We have this printed here for your

reference. And then the next slide has almost a virtually identical standard for the prohibition of electric market manipulation. Importantly, at the end of both slides, you see that these provisions should not be construed to authorize private rights of action.

Now, on page 10 of the slides, what are the elements of a claim of market manipulation by FERC? Well, importantly, the commission may act against any entity, and that is broadly defined, and we will discuss that momentarily, any entity that uses a fraudulent device, scheme or artifice or makes a material representation or a material omission as to which there is a duty to speak, or – and this is very broad, you'll notice – engages in any act, practice or course of business that would operate as a fraud or deceit upon any entity. (C-Enter) is required, and we will talk about that. And the authority applies in connection with the purchaser's sale of any electric energy or natural gas.

What does – what does any entity mean? Well, you see here on the second bullet that this applies to even traditionally non-jurisdictional entities, like the Bonneville Power Administration, Tennessee Valley Authority. Municipal power agencies that traditionally are not subject to FERC's regulation are subject to their anti-market manipulation rules. So this rule and Congress' authority defer casts a very, very broad net over the industry and users of the transmission system or the natural gas pipeline system, and those who engage in transactions that are subject to the jurisdiction of the commission.

On the next slide, you see the phrase – well, this slide points out that section 1-C is very, very broad. It has a catch-all provision intended to catch a variety of conduct. But what it catches must be – must be a fraud, and the commission has said that it will determine fraud as a question of fact based upon all of the – all of the circumstances before it, and I think it's very clear, from what the commission has said in its publications and orders and what the chairman and commissioners have said, that they intend to define this on a case-by-case basis going forward rather than generically.

On page 13, what does in connection with a jurisdictional transaction mean? Well, what if there is a fraud or deceit that is very remote from a jurisdictional transaction but still affects it? Well, the commission has said in committing the fraud, the entity must have intended to affect or acted recklessly to affect the jurisdictional transaction. So in other words, the commission does not intend to construe this new authority so broadly that every fraud that one could commit that might down the line affect jurisdictional transaction is swept in. The commission has said that that is not what it intends.

Next slide, please.

**Bob Fleishman:** OK, let me pick up from here, and I'll be talking briefly about some of the recent FERC enforcement settlements and some of the show-cause proceedings and then a little bit about what it is doing in the area of reliability standards with respect to the bulk power system.

As Bill said, beginning in August '05, and then in October '05, the commission started to begin exercising its authority, but if one were not actually involved in an investigation on behalf of a subject in an investigation, it'd be very hard to see what exactly they were doing. But beginning in early 2007, the commission started to issue a number of orders which reflected settlements in the – in the enforcement area, and we've identified, on the next couple of slides here, about 17 of them which have been issued so far, both on the electric side of the business and the natural gas side of the business, and there's a combination of civil penalties, disgorgement, and also there is a – almost always a compliance planner or compliance program component to these settlements.

Two of the more recent ones – I'm on page 16 – I would point out here are an Edison Mission and the Ducain case. Edison Mission is interesting because for the first time we see FERC specifically talking about penalties in connection with a lack of candor, a lack of candor between the company and its representatives in the enforcement investigation and the enforcement staff of

the commission and the commission itself. Also, what we see in both the Ducain and Edison Mission cases are now specific dollar amounts, two million and one million respectively, that are set out in the enforcement order settlement for compliance programs, and this is a new development at the FERC.

There are also two high-profile, what are called show-cause proceedings, going on now at the Federal Energy Regulatory Commission, one in connection with Energy Transfer Partners and one in connection with Amron. Covington & Burling is co-counsel in the Energy Transfer Partners case, and this one briefly has a trading activity set of allegations and some undue discrimination allegations. It's claimed by the agency that there was alleged manipulation of physical gas prices by ETP, Energy Transfer Partners, that impacted its financial position and some basis swaps. And then, with respect to the Intrastate Pipeline Oasis, there are allegations of affiliate abuse, undue discrimination and so forth. A – hearing schedules are setup. There will be trials in both of these matters within the next year. The agency's seeking about \$200 million in civil penalties as well as disgorgement. In addition, it's using the full range of its remedial authority by indicating it may possibly revoke the marketing certificate of ETP, and this is based upon not the market manipulation rule per se, but rather some rules that were in effect, the so-called market behavior rules that were in effect during the time of the alleged violations in that case.

The other show-cause proceeding, which is really a litigation before an administrative law judge at the agency, at the FDRC, involves Amron, and this is an allegation of manipulation of futures contracts that, according to the agency, impacted physical gas prices. In that situation, over \$300 million in civil penalties as well as disgorgement are being sought. In addition, that is based on the current market manipulation rules that Bill Massey just talked about, and these two are really the first cases that will set forth what the market manipulation rules are.

In addition, very briefly on page – slide 19, the FERC now has a mandatory and enforceable reliability standards with respect to the bulk power system, and this is a function of the Energy Policy Act of 2005, Section 215, and in the wake of the blackouts in 2003, the commission received tremendous amount of authority to enforce mandatory reliability standards. There is a role certainly on the enforcement and the enforcement side for not just the FERC, but the NERC as well as the various regional entities, and for the initial period during which these reliability standards were in effect, there were recently 37 notices of penalty by NERC submitted to the FERC.

That was in June of 2008, and the FERC recently issued an order, which essentially accepted the penalties, either the assessment of penalties that were about \$250,000 in penalties assessed to two particular companies, and it also accepted the determination by NERC and the regional entities of zero assessment of penalties in connection with the other 35 entities. It also took the occasion to issue a guidance order where it set forth its expectations in the area of settlement, completeness of information, documentation and so forth, and many of the references in that are directly from the policy statements, the 2005 policy statement, as well as some specific rulings it has made on a generic basis as to how it wants to see enforcement in the reliability area.

Let me now turn things back to Bill Massey, who will talk about the new enforcement package and the events that led up to that beginning in November of 2007.

**Bill Massey:** Yes, in November of 2007, FERC held a daylong conference on enforcement and invited industry representatives, consumers and others to come in and provide comment about the way in which the commission was using its new enforcement authority.

Covington & Burling was hired by seven D.C. based energy associations on both the gas and electric sides to prepare a white paper that provided suggestions to the commission about how it might improve its implementation of its enforcement policy. We had a number of suggestions about how the commission could achieve its goal of firm but fair enforcement, and I'm pleased to say that a number of those suggestions that we're getting include the white paper that we

prepared and I testified before the commission have now been implemented by the commission, not all of the recommendations, but a good number of them, and on page 20, you will see a package of orders that the commission issued in May of this year on the issues that were raised in that conference.

Moving to page 21, the first one mentioned there is a revised policy statement on enforcement. The commission said, look, we want to have a more transparent process, so market participants will understand how we make our decisions and how we're going to process cases. So they provided a good deal more detail about the conduct of investigations and audits, how enforcement staff decides whether to open an investigation. There had not been a lot of public information about that, and the commission set out how they make that decision.

How does the commission determine an appropriate civil penalty? It can be up to \$1 million per day per violation, but the commission has a good deal of authority. How does it exercise that authority? On the next page, the commission also promulgated some new policies relating to how the industry communicates with the commission during investigations. So there are certain things that, if you're the subject of an investigation, if you're a company that is before the commission, there's certain things that you can communicate about, certain ways that you can communicate, and certain ways that you are not to communicate with the commission.

What are the due process safeguards during the investigation? A number of witnesses at the November conference spoke about the need for somewhat greater clarity on the issue of due process. Well, the commission has now said that this is – this is important. This was ambiguous, but neither the commissioners nor their assistants will receive any oral communication from any person concerning an ongoing staff investigation, which that person is subject. There was some uncertainty about that. Could a company that was subject to a non-public FERC enforcement action actually have their lawyer call up a commissioner or call up a commissioner's assistant and make an argument, and FERC has now said no, you may not do that.

However, a number of companies that are involved with FERC enforcement matters also have a lot of other business before the commission, and the commission said, well, with respect to your other business before the commission, you can, of course, continue to communicate with the commission in ways that are consistent with our general ex parte rules.

And then the third bullet on page 23 is very important. The commission said, look, if you're subject to an enforcement action, you could submit a written submission to the commission at any time during an investigation. This is akin to a well submission before the SCC. But FERC is saying, look, you can do it at any time. What are the due process safeguards that the commission has now adopted? The commission has now designated enforcement staff as – will designate enforcement staff as non-decisional employees at the time of an order to show cause.

Next slide, Bob. How does the commission determine what a civil penalty should be? The commission built on what it had announced back in 2005 and said, look, we're going to look primarily at two factors. We'll look at a variety of factors, but two stand out. First is the commitment of a company to compliance. We want a lot of evidence about that. And secondly, what is the seriousness of this offense, and the commission has now issued a good deal of more detail regarding the other factors that it considers, as well, including the elements of a good compliance program.

The commission has now published a list of those elements for companies that wish to – wish to adopt really good compliance programs to stay out of trouble with the agency. The commission has said, look, these are the elements of a good program, a program that we will consider to be of high – of high quality. And the commission said, look, we want market participants to self-report. If you discover that you have violated a commission rule, we want you to come into the commission and report that to us confidentially, and the commission set out a list of factors that would be looked at by the commission to determine whether your self-report was adequate.

Next. Are we on the next slide? Yes. The commission in this package of orders also expanded the scope of its no-action letter program. Previously, a market participant could submit a request for a no-action letter for a very, very limited number of potential violations. Now the commission has said we are going to expand that no-action letter policy to include virtually any rule or regulation of the commission. In other words, you can come to the agency and say, look, this is the conduct that is involved. This is the – these are the circumstances. Tell us whether engaging in this conduct in these circumstances would be a violation of your rules, and the commission is now broadly expanded that program, which we recommended in our – in our white paper.

We also recommended that the commission established a help desk so that market participants could make a call to the commission and submit oral questions regarding compliance and get some oral guidance from the staff about the kinds of conduct that might pose problems for market participants, and I think that is a very nice tool that market participants can use right now.

What about ex parte contacts? We've talked about that a little bit. We raised this issue in the white paper. The commission has promulgated a rule that specifically states that its separation of functions and restrictions began to apply when the commission issues an order to show cause after an investigation. Those restrictions do not apply during the early stages of the investigation, but the kick in after the commission issues an order to show cause. Another rule states that ex parte restrictions also begin to apply when the commission issues an order to show cause.

And then slide 28, the commission amended the code of federal regulations to give the subject of an investigation the right to be notified that staff intends to recommend an enforcement action, and that subject of the investigation can then make a non-public submission to the commission explaining why an order to show cause should not be issued. This was implicit in the earlier rules of the commission, but the commission has now made this very explicit because a number of market participants have asked for this guidance.

And then, on July 8 or 2008, the commission held a compliance workshop. As mentioned before, there was a good deal of interest in the question of how to design a very good compliance program, and the commission had a day-long workshop on that topic, which I think was very edifying for members of the general public and for market participants.

**Bob Fleishman:** This is Bob, and I'm going to pick up with certain key information about the CFTC in light of their activity in the area, and I'll just talk about that briefly. Before we leave this area, though, I just want to say in your links box, there is a link to the enforcement white paper in November 2007 that Bill Massey was referring to just a moment ago.

The CFTC also has tools somewhat comparable to those of FERC, but its tools are under the Commodity Exchange Act, and very recently, in the last couple of months, Congress gave the CFTC the same type of civil penalty authority, the one million a day for certain types of offenses that the Congress gave to FERC in 2005 that previously had been a much smaller number. It had been \$100,000 or triple the monetary gain. But if we're talking about manipulation, either attempted or a successful or perfected manipulation, the CFTC now has greatly enhanced authority.

The CFTC's basic jurisdiction over energy transactions is with respect to on exchange trading in futures and options contracts that are based on commodities. Most of those are done on exchanges such as NYMEX, which is considered to be a designated contract market, or DCM. The CFTC does not regulate trading of energy products on the spot market or on forward markets which are excluded from its jurisdiction. However, and this is an important point, it has enforcement authority under such markets as contrasted with regulatory authority.

Recently, the Congress and the Farm Bill of the reauthorization of CFTC in May took steps to close the so-called Enron loophole, and some of you may have heard of that briefly. What that

refers to is that in 2000, the commodities were basically divided into three categories. One category was agricultural commodities. A second category was excluded commodities: interest rates, exchange rates and so forth. And then there was a third category known as exempt commodities that were neither of the first two categories. Oil, gas, electricity and other energy products fall into that third category, and that is the so-called Enron loophole, and with respect to energy-based futures, the – that 2000 law exempted two types of markets from much of the CFTC's oversight, so-called exempt commercial markets or ECMs. Basically, this was bilateral trading between two eligible contract participants or electronic multi-lateral trading entered into on a principle-to-principle basis among certain eligible commercial entities. Essentially ICE, the Intercontinental Exchange, is an example of such an electronic multi-lateral trading system.

And so there is now greater authority that the CFTC has to exercise authority over contracts that provide a significant price discovery function. Well, what is that? The chairman of the CFTC explained that although the exempt commercial markets have increased competition and lowered cost, certain of the contracts on exchanges such as ICE function as virtual substitutes for contracts that are listed on the regulated exchanges like NYMEX, with tight correlation and linking of prices and participants, and if there are contracts that in the future provide a significant price discovery function, then the CFTC will be able to regulate that in a variety of ways. They will – must comply with certain core principles involving the monitoring of trading, listing only contracts that aren't susceptible to manipulation. There will be position limits. There will be a publishing of daily information on a mandatory basis as opposed to voluntary, and there will be a rule-making proceeding over the next year or so at the CFTC that will flesh out any of the details in connection with this.

There have been two recent anti-market manipulation enforcement actions that the CFTC has been involved with. I'll talk about it briefly. The first involved Energy Transfer Partners, and again, the second involves Ameron because the CFTC and FERC were working very closely in those investigations. The CFTC, though, with respect to the physical trading activity by Energy Transfer Partners, alleged attempted manipulation, not perfected manipulation. They brought their case in federal court, and that matter was recently settled with the CFTC for approximately \$10 million.

On the Ameron case, which is proceeding as Ameron advisors and Brian Hunter was one of the key traders involved in that alleged scheme. Again, it was essentially the same type of allegations as FERC had brought except that here they were focused on a depressing – alleged depressing of settlement prices that the futures contracts traded on NYMEX to benefit large or short positions that were traded on ICE.

What we have seen particularly with the Ameron case is a blurring of jurisdictional boundaries, and the two agencies are focused on activities that really had been before much the province, if I may, of the other agency. CFTC, we're seeing is increasingly focused on the physical and cash side of the markets, and FERC is now interpreting its new anti-manipulation authority, the in connection with language that Bill Massey spoke about in connection with FERC's market manipulation pools in a way that allows it to proceed in the Ameron case at the FERC against financial counterparties in the OTC derivatives markets, and the fact that, from FERC's perspective, it affects a FERC jurisdictional physical transaction is what FERC is principally relying on, and on the other hand, we have the CFTC and those who are alleged to have been involved in these manipulations arguing that the CFTC has exclusive jurisdiction in this kind of situation. The court rulings to date have principally come out on the side of the FERC. It's also fair to say that those proceedings are not nearly done.

For those companies who are involved in trading activities, please know that you need to become even more familiar with the way that both of these agencies operate, the different kinds of legal standards and the kinds of market activities and practices that they – that they really go after and focus on, and again, the distinction between regulatory jurisdiction on the one hand and enforcement authority is something that people really need to focus on as they move forward.

Let me now turn the baton back to Bill, who will talk about at FERC what are maximum and near-maximum civil penalties being handed out for.

**Bill Massey:** Yes, last fall at the enforcement conference, a number of participants said to the commission we would like to know more about how you determine penalty levels. We're having some difficulty understanding the processes of the commission and the factors that you take into account, and we'd like to know more about what you really consider to be the most serious kinds of offenses. I think it's – I think it's clear that the commission will impose higher penalties for violation of so-called core regulatory responsibilities in serious offenses.

Well, what does that mean? Well, certainly a violation of the market manipulation rules is a core regulatory responsibility and one that Congress is overseeing with great diligence. Violations of reliability standards, and that is clearly a core regulatory responsibility of the commission. The commission is now the reliability regulator for the bulk power electric system for the entire nation, including Texas. Violations of affiliate abuse standards, or standards of conduct are considered to be serious offenses by the commission. Most of the time I served as a commissioner, we were very focused on the subject of affiliate abuse when it came to a transmission provider or a natural gas pipeline providing some sort of special treatment for its affiliates, and that is a primary concern of the commission.

The commission considers violations of its so-called "shipper must have title" rules to be one of its core responsibilities to police. This came as a surprise to some market participants, but this rule applies on the natural gas side and basically says that a shipper of natural gas on the interstate pipeline must have title to the gas that it ships on its own capacity, and the commission is now enforcing that vigorously.

Network transmission rules are core regulatory responsibilities. And then we now know, and we probably knew it before too, but the commission has made this very explicit, that if a market participant in an enforcement matter is not candid with the commission, misrepresents certain facets of the commission, the commission will take that very, very seriously and really staying with high penalties. And then, finally, if there is a demonstrated lack of commitment to compliance, the commission considers that to be a very serious offense.

What are the mitigating factors? Well, the flipside, if you have strong internal compliance measures in existence at the time of the violation, you've been paying very close attention, you have strict standards internally but something slips through the cracks, the commission will consider that to be a mitigating factor.

If you sell for a porta violation, you discover that you have violated a rule and you go to enforcement staff confidentially and say, "We think we violated a rule and we want you to know about it," that will be a mitigating factor.

Exemplary cooperation, now the commission says this means more than just the cooperation that you'd normally expect from a market participant that is involved in an enforcement matter. This is a higher standard than that. And for exemplary cooperation, you will get credit.

If you rely on staff guidance, you call the help desk, for example, and you get – and you present certain facts to commission staff and then you rely on the staff's decision, their recommendation. Then you get credit for that as well.

What are the aggregating factors? Again, a weak compliance program, if you simply aren't paying enough attention to compliance internally, repeated violations – that seems pretty obvious, if your conduct harms the market. If there's no harm from the market that it perhaps will be subjected to a lighter penalty or no penalty at all. But if you harm the market certainly that's an aggregating factor.



If you don't report the violation to the commission or if you don't correct your conduct – if you know, for example, that you may be violating, the shipper must have tighter rules and you don't do anything about it that would be an aggregating factor.

And then if you don't cooperate with FERC staff during the course of the investigation, that's an aggregating factor.

This may be – this slide may be obvious, what are the goals of the successful compliance program? We've talked a lot about compliance programs. Well, first of all, to avoid violations, and secondly, if you do engage in a violation to mitigate the adverse consequences and they will – and they likely will occur in view of the numerous requirements.

Next slide, Bob. All of us have a successful compliance program. Well, you have to develop a culture of compliance. According to the commission, this starts at the top with visible senior management, commitment that emphasizes high ethical standards and common sense. FERC wants you to select the right compliance officer, a no nonsense kind of person who is willing to say – to say no when company employees ask about whether they can engage in certain questionable activities.

Systems and protocols for monitoring, identifying, and correcting possible violations. In other words, the commission doesn't just want you to talk the talk. They want you to walk the walk. They want you to put in place internal controls for compliance.

You can have a compliance program, but if you don't follow through the commission will notice that. Internal monitoring and regular audits are important in a good compliance program.

And this is important as well, staff training. Your – the staff of your company need to understand policies and rules so that they can comply with the requirements. And some of the requirements are fairly technical.

And then accountability. The commission wants to look at your program and determine who's responsible, who's accountable, and how do you enforce accountability within the company?

And then finally, the commission wants you to document the elements of your program, make sure that your program is broadly disseminated to all of your workers, make sure there's no gaps in the program. If there's a certain area for policy or rules that you're just not dealing with, that's a problem.

And then FERC has issued a number of checklists for good compliance programs that you ought to be very mindful about. What about self reporting? The commission says that if you self report – in other words, if you mess up, violate a rule, and then they want you to come in and tell them about it.

And FERC says that if you do that, it will result in lower civil penalties than would otherwise be the case. And if you don't self report and you get caught then there'll be higher civil penalties.

FERC has issued a document saying that 79 percent of self reports are resolved without the payment of civil penalty and that 21 percent have resulted in civil penalties, none of which have approached the maximum civil penalty level.

So the commission constantly is reminding market participants about the importance of self reporting.

**Male:** Let me finish up on the next few slides by talking a bit about how one can attempt to defeat an alleged misconduct claim, recognizing that there are many different kinds of misconduct or activities that might come within the abbot of the FERC enforcement folks.

And recognize that there are a couple of different paths one may have to take, or decide to take, if there is a misconduct claim. There might be a litigation. A show cause proceeding seems to be how those litigations are working their way through the FERC at this point. There could be an enforcement settlement, which would be issued in a public order after a non public investigation.

Another path that I believe over time will become more popular – the nuclear regulatory commission uses this – is to have mediation, which is one of the tools in alternative dispute resolution, be a way to resolve – maybe not necessarily defeat – but resolve an alleged misconduct claim, recognizing that there are many costs involved with an investigation and the defense of such matters. Besides for legal costs there are the internal resources, the distraction, and obviously the reputational harm that can come about when it becomes known that you either are the subject of an investigation or you actually have an enforcement settlement or a litigation that's actually ongoing.

A couple of things to keep in mind in potentially defeating a misconduct claim, continually ask yourself, "Are your business practices ones that have a legitimate purpose?" that the more that what can be engaged in is activities that can be said to be in the normal course of business. That is going to be certainly a helpful thing.

It's also helpful to focus on whether the rules that one is being alleged to have violated was one that was ambiguous or rather one that was clear. It's going to be much tougher at the end of the day to defeat this conduct claim where a rule was quite clear as opposed to one where it was a little bit fuzzy about what the actual rules of the road were.

Also with respect to the commission itself – and this is something that the enforcement staff may not be as focused on – but what are the public policy considerations that would result if the enforcement action that you're potentially involved in becomes public and that becomes a you know a wide precedent in the industry. How will that affect the various policy objectives that the FERC has with respect to its electricity program or its natural gas program?

There are a number of different impacts and risks for market participants. We've talked about civil penalty liability. Recognize that many of the same kinds of activities could be the subject of a CFTC matter or investigation or litigation. Similarly with the justice department, there could be state agencies who get involved as well.

Bill Massey talked at the front end about criminal liability. There's also the potential for lawsuits, both class actions and private rights of action if it's not a market manipulation case, and of course the reputational harm. And that is not a small matter.

And our general advice in terms of how to manage one's risks is to take as many proactive measures as one can take. Certainly compliance program is one of them. Careful writing, training, there are a number of things that one can do to try to get ahead of the curve.

One final set of thoughts, though, suppose despite best efforts to not be found to have engaged in any unlawful acts, you have either a settlement that is about to issue – or does get issued – or a litigation that's commenced by the FERC, how do you manage the, what we'll describe as the fallout because one needs to minimize the negative impact on the many stakeholders that a company will have, employees and counterparties and vendors and lenders and so forth?

And our general advice is think of this is as a crisis communications, a crisis management type of situation. Try to get out in front of the issues at the right time. Try to have as clear an assignment of responsibility for who are the spokespeople, how are decisions going to be made

as possible. You want to have as clear channels of internal communication as possible and control the information at least to the public. And that needs to be balanced by the competing – sometimes competing needs for transparency on the one hand and credibility on the other.

And to the extent that one can identify members of the media or other what we describe as external validators or other sources, in around the time that your matter becomes public, we think that that is a very wise path to proceed on. And in a sense, at a certain point it can become a managing of public relations situation.

Sometimes your in-house communications people are perfectly adequate to the task. Sometimes it does make sense to work with a public relations firm or a firm that's dealt with crisis communications that's you know been in very tough situations. And it is always helpful and important to coordinate closely with council.

With that, we'll be happy to take any questions. And Nicole, if you'd like to remind people how to...

**Nicole Spaur:** Sure.

**Male:** ...send their questions, which would be good.

**Nicole Spaur:** Great. Just quick reminder, if anyone has a question, you can type it in the box located in the lower left corner of your screen and then just simply hit send and the presenters will be able to see that.

I guess I have a question to kind of kick it off here. For companies that you know may be small in size or very cost sensitive, what tips can you give in terms of putting together inexpensive but effective compliance programs?

**Male:** Bill, let me take the first shot at that. I think that the FERC recognizes that every compliance program needs to be tailored to particular organizations. And while they have a checklist of items that they consider to be guidance – I think there are 10 or so of those – I think that it's very important for a smaller company to first focus on what is the culture at the company and try to make sure that management teams, senior management teams, is committed to having a compliance program that is right for that organization.

I think also one will need to look at what are the kinds of risks that the company is likely to have? A smaller company is likely not to have as many rules at the FERC that it need be concerned about. So you don't necessarily need a program that covers 52 items. It might be perfectly adequate to cover 10 items very well and also then have procedures in place to deal with other areas that are of lesser concern, not any concern but of lesser concern.

And it is also best to try to work with either a consulting firm that has done this kind of work before a legal firm that's done this kind of work before so that to the maximum extent possible there's not reinventing of the wheel connection with the activities and recognize that you know it will not be inexpensive but I don't believe that the agency expects a very small company to have a sophisticated and as expensive a program as much larger entities out there.

But they do expect companies of all sizes and shapes to have some type of compliance program and a commitment to compliance.

Bill, anything you'd like to add to that?

**Bill Massey:** Oh, I'm sorry. I was on mute. I was waxing eloquent. It was good, too, I'll say. I think the key for any company, small or large, but – is to make sure there's a commitment at the

top. And to get the buy-in of senior management to a compliance, a program, and shape the program around that.

As Bob said, I mean, if you were one of the primary jurisdictional companies at FERC and you've got a lot of business there, you're expected to have a more sophisticated program in place than a small player. But still, I think even the smaller players are expected to have a commitment from the top down to compliance standards and rules in place and I think a good employee training program so that those who deal with FERC jurisdictional markets on a day-to-day basis, if you make quick decisions about various kinds of conduct, know what the rules of the road are.

And I think that is absolutely a critical first step in promulgating a compliance program for a small company or a large company.

**Nicole Spaur:** Excellent. I keep hearing over and over senior management being one of the themes. Obviously you know you need their buy-in. That's where FERC is going to look to see where you know the position of senior management. Any you know like great sound bytes for in-house council that we can kind of relay to our senior management to ensure that they you know understand these issues, that we get the buy-in that I think we need to have to have successful compliance programs?

**Bill Massey:** Well, this is Bill Massey. I would say that the elevator speech is – FERC now has the authority to impose a million dollars a day per violation. And for a small company, you know that adds up very, very quickly.

And I think the fact that the commission now has this authority and frankly is exercising it with – aggressively to weed out market manipulation and other violations of rules – and by the way, if we didn't make this clear, this authority now extends to the violation of any FERC rule or order or policy or tariff. So it's incredibly broad.

And I think I would emphasize both the breadth of FERC's authority, number two, that it applies to any entity, not just traditionally jurisdictional entities, and number three, that the commission is very, very serious about its million a day authority.

**Male:** And two additional things I would add is that when one looks at the enforcement settlements that have become public, one sees settlements not just with the largest, more traditionally regulated companies, the you know the Scanas and others at the agency, but rather one also sees it with smaller companies, Bangor, Maine, Gecksa, smaller companies. In addition, the orders both on the enforcement settlements and also with respect to the show cause proceedings very much focus in terms of their assessment of civil penalties on the involvement or not, the knowledge or not, the complicity or not, of senior management in the particular situations.

And when they are looking at the factors, they've noted that – of course, seriousness of the offense and the commitment of the company to compliance are key. And then when one looks at the other eight or nine factors that they identify, the involvement or knowledge, et cetera, of senior management, we see that not just in their policy statements but in their orders where they're assessing penalties or alleging misconduct in show cause proceedings, the litigations.

**Nicole Spaur:** OK. Excellent. Well, I think with that our time is coming to an end here, so I'd like to thank both Bob and Bill today for presenting on such a timely topic. I know this topic is getting a lot of attention. And I hope that all of our participants found the information you provided very helpful. I know I enjoyed it.

I also want to thank your law firm, Covington and Berling, for sponsoring today's Webcast. And for all the attendees, if you would take a moment to complete the Webcast evaluation, you can click on the Webcast evaluation link on your screen and fill that out. We would really appreciate the input as we continue to prepare for future energy-related Webcasts.

And with that, that concludes today's Webcast. Thank you.

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